

Message Text

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TO AMEMBASSY LONDON PRIORITY

S E C R E T STATE 299308

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EYES ONLY AMB, DCM, ECONMIN, POLCOUNS

FOLLOWING REPEAT 299308 ACTION USDEL SECRETARY DTD 09 DEC

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S E C R E T STATE 299308 TOSEC 320103

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PASS HARTMAN FROM ROGERS AND KATZ

E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: UK FINANCIAL PROGRAM AND STERLING BALANCES

1. THE HMG HAS NOW REACHED BASIC AGREEMENT WITH THE IMF ON DOMESTIC POLICY CONDITIONS FOR THE \$3.9 BILLION IMF LOAN ALTHOUGH THERE IS ONE LOOSE END REGARDING HOW THE TARGET FOR THE PUBLIC SECTOR BORROWING REQUIREMENT WILL BE MET (THE BRITISH WANT TO RAISE SOME TAXES TO AVOID EXPENDITURE CUTS; IMF FINDS THIS TOO DEFLATIONARY). CALLAGHAN WILL REPORT THE RESULTS TO PARLIAMENT NEXT WEDNESDAY. HEALY ANNOUNCED YESTERDAY THAT HMG EXPECTS AT SECRET

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THE SAME TIME TO ANNOUNCE AGREEMENT ON SOME ARRANGEMENT FOR OFFICIAL STERLING BALANCES.

2. WE DO NOT YET HAVE DETAILS OF THE IMF PACKAGE, BUT

INDICATIONS ARE THAT IT IS ADEQUATE AT BEST IN TERMS OF HOLDING DOWN PUBLIC EXPENDITURE AND CONSUMPTION. IT IS THEREFORE UNCLEAR HOW THE MARKET WILL OVER TIME REACT. IF THE BRITISH DO NOT TAKE FURTHER ACTION OVER COMING MONTHS, THERE COULD BE FURTHER DOWNWARD PRESSURE ON STERLING AT SOME POINT, AND FURTHER DRAWDOWNS OF OFFICIAL STERLING BALANCES.

3. IN THIS CONTEXT, AND IN VIEW OF STRONG WARNINGS FROM REUSS AND OTHERS IN CONGRESS, WE DO NOT REPEAT NOT CONSIDER IT FEASIBLE TO OFFER HMG ADDITIONAL, UNCONDITIONAL CREDIT LINE AS STERLING SAFETY NET, AS IS LIKELY TO BE PREFERRED BRITISH OUTCOME. RATHER, WE CONCUR GENERALLY IN PROPOSAL DEVELOPED BY ED YEO THAT WOULD CONSIST OF COMBINATION OF SHORT TERM SAFETY NET AND FUNDING, ALL WITHIN AN IMF FRAMEWORK, IN RETURN FOR A COMMITMENT TO PHASE OUT STERLING BALANCES OVER TEN TO FIFTEEN YEAR PERIOD. SUCH A PROGRAM WOULD HAVE TO INCLUDE A CONTINUED MONITORING OF THE UK ECONOMY, WHICH WOULD NOT BE WELCOMED BY HMG, BUT THIS SEEMS TO BE THE ONLY WAY TO BALANCE FURTHER MAJOR FINANCIAL COMMITMENTS ON OUR PART.

4. KARL KLASSEN OF THE BUNDESBANK, WHICH WILL BE THE GERMAN PARTICIPANT IN ANY STERLING BALANCES DEAL, HAS TOLD YEO TO GO SLOW AND WILL NOT MAKE ANY COMMITMENTS UNTIL THE LAST "T" IS CROSSED ON THE UK'S NEGOTIATIONS WITH THE IMF. NEVERTHELESS, ED YEO IS PREPARED TO GO TO LONDON EITHER BEFORE OR AFTER HIS WEEKEND STAY IN PORTUGAL. DEREK MITCHELL OF HMG TREASURY WANTS TO REACH YEO ON THE PHONE TOMORROW REGARDING SCHEDULING. HE WILL BE CONSULTING BEFOREHAND WITH CONGRESSIONAL LEADERS AND WITH OTHER MAJOR CREDITOR COUNTRIES.

5. WE DO NOT KNOW AT THIS STAGE WHAT THE BRITISH REACTION WILL BE TO OUR PROPOSAL ON BALANCES. CERTAINLY THERE WILL BE SOME RESISTANCE TO CONTINUED CONDITIONS ON UK ECONOMIC POLICY, AND THERE MAY ALSO BE RELUCTANCE TO ACTUALLY
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NEGOTIATE PHASE OUT OF STERLING BALANCES, ALTHOUGH THE HMG HAS IN THE PAST INDICATED THIS IS ITS LONG TERM OBJECTIVE. IN ANY EVENT, THIS PROPOSAL IS UNLIKELY TO BE NEGOTIATED BY NEXT WEDNESDAY, AND THE BRITISH REACTION COULD EVEN BE TO DRAG OUT THIS ISSUE UNTIL AFTER JANUARY 20.

6. IN YOUR TALKS WITH CALLAGHAN AND OTHERS IN LONDON YOU MAY WISH TO MAKE THE FOLLOWING POINTS:

-- WE ARE DELIGHTED YOU HAVE BEEN ABLE TO WORK OUT AN ARRANGEMENT WITH THE IMF TO OBTAIN THE \$3.9 BILLION CREDIT LINE.

-- ED YEO WILL BE TALKING TO HIS COUNTERPARTS IN THE HMG

TREASURY REGARDING ARRANGEMENTS FOR OFFICIAL STERLING
BALANCES.

--HOPEFULLY THESE TALKS CAN PROGRESS RAPIDLY.

YOU SHOULD PROBABLY TAKE ANY BRITISH COMMENTS ON STERLING
BALANCES AND OFFER TO DISCUSS THESE WITH YEO, AVOIDING
A NEGOTIATION BEFORE YEO HAS PRESENTED HIS PLAN IN FULL
TO THE BRITISH. ROBINSON UNQTE ROBINSON

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